

stock of autos may be involuntary, with the result that production will be cut back. This could mean less buoyancy in the first half of 1968 than the Council expects. Steel inventories will continue to increase in the months ahead; but they will inevitably be reduced later in the year, either during a strike or following a settlement. Production, employment, and the general level of demand will all be adversely affected, whether or not a strike occurs. Thus, in the absence of other reasons for accumulation of inventories, the main source of the acceleration of growth during the second half of 1967 would be operating to retard growth in the second half of 1968. Enactment of the tax surcharge would compound the effects of inventory reduction.

Examination of the Council's sector-by-sector forecasts, which are premised upon enactment of the surcharge, adds to misgivings about the wisdom of the surcharge proposal.

BUSINESS FIXED INVESTMENT

The Council expects business fixed investment to be \$4 to \$5 billion higher in 1968 than in 1967. Insofar as the first half of 1968 is concerned, this forecast is based upon anticipated investment as reflected in the Commerce-SEC survey. In 1967, however, the anticipations reflected in that survey turned out, quarter-by-quarter, to be substantially overoptimistic when data on actual investment became available. In the first and second quarters of 1967, increases over the respective preceding quarters had been anticipated by actual investment decreased. The average error for the first three quarters (fourth quarter actual data are not yet available) was more than \$2 billion at an annual rate.

Preliminary figures for 1967 (with the fourth quarter taken at the anticipated level) show an increase of little more than 1 percent over 1966 in current dollar business expenditures for new plant and equipment, which would mean a decrease in real investment. The reason is readily apparent. From 1963 through 1966, real plant and equipment investment had been increasing twice as fast as real GNP. Such a discrepancy was clearly unsustainable.

Excessive investment and lagging demand inevitably resulted in a sharp decrease in capacity utilization. In manufacturing, for example, Federal Reserve Board data show that capacity increased by 6.4 percent from the fourth quarter of 1966 to the fourth quarter of 1967. Output during the same period declined by one-half percent. As a result, capacity utilization dropped from 90 percent to 84.3 percent.

With a wide margin of existing capacity unused, it is not at all surprising that anticipated increases in plant and equipment spending fail to materialize. The Council may be in for a disappointment in the nonelectrical machinery industry, for example. This is one of the industries mentioned by the Council for which the Commerce-SEC survey "reported plans for considerable increases in investment in the first half of 1968." However (according to McGraw-Hill figures), the operating rate in nonelectrical machinery dropped from 93.5 percent of capacity in December 1966 to 80.5 percent in December 1967.